September 18, 2014

Rating matrix

Rating	:	Unrated
Target	:	NA
Target Period	:	NA
Potential Upside	:	NA

Key Financials

₹ Crore	FY11	FY12	FY13	FY14
Revenue	170.9	178.1	198.8	229.5
EBIT	136.3	151.4	159.9	180.9
Net Profit	91.0	107.5	113.3	128.7

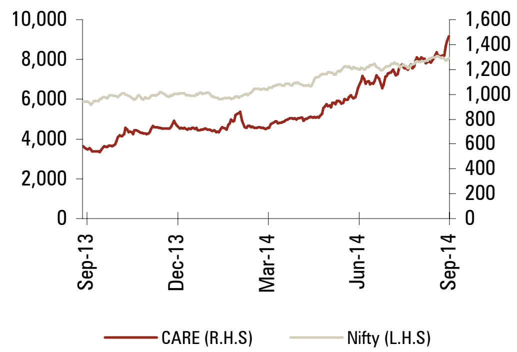
Valuation Summary

₹ Crore	FY11	FY12	FY13	FY14
EPS	30.5	36.1	39.7	44.5
P/E (x)	47.5	40.2	36.5	32.6
RoE (%)	35.2	31.6	28.3	27.3
RoCE (%)	52.8	44.5	39.9	39.2

Stock data

Particulars	
Market Capitalization	₹ 4263 Crore
52 week H/L (₹)	1470 / 532
Equity capital	₹ 29 Crore
Face value per share	₹ 10
FII Holding (%)	20.2
DII Holding (%)	51.7

Price movement



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Credit Analysis & Research Ltd (CARE)

₹ 1450

Strong play on rating industry...

We met the management of CARE to further comprehend its business positioning in the rating industry and general outlook for the industry. Incorporated in 1993, CARE has steadily gained pace in the past six years to become the second largest rating player in India after Crisil. Currently, among top three rating agencies, CARE is a pure play on the rating business as almost its entire revenues are earned from rating functions. The company is promoted by domestic financial institutions including IDBI, Canara Bank and SBI unlike Crisil and ICRA, which have foreign parents in S&P and Moody's, respectively. The business model of CARE is asset light in nature and generates operating cash flow of ~₹ 100 crore in a year. As anticipated, with cash of ~₹ 500 crore as on Q1FY15, CARE announced an interim dividend of ₹ 65/share that was well received by investors while efficient cash utilisation is boosting its low payout ratio.

Rating business to remain core area ahead; focus to be on SME ratings

As per the management, rating will continue to be the company's core area of business for the next few years wherein international expansion is expected to be seen. The management said they have adequate resources and are on the look out for any good acquisitions in the research space. In the rating business, the company, apart from its active segments of bond market & bank loan rating (BLR) is focusing on the SME business. Currently, out of its ~600 employees, ~175 are engaged in the SME business while it is hiring more to develop the segment. It expects to maintain its market share of ~25%, going ahead. The recently allowed infra bonds could be a good business opportunity.

CARE has grown at relatively faster pace

CARE's revenue have grown at >30% CAGR to ₹ 230 crore over FY08-14. This is relatively higher than its peers as it gained market share mainly by strongly capitalising on the BLR business after Basel II norms came into effect post 2008. On the bond rating front, card rate is ~10 bps as initial fee and ~5 bps of surveillance fee each year. In case of BLR, the initial fee is ~4-5 bps. The surveillance fee comprises ~50-55% of total revenues.

Stock performance – best among peers in past six months….

In the past six months, the stock has seen a sharp rise (up ~95%), which was better than other two listed agencies. Recently, FII holding in the stock has also risen to 20.2% as on Q1FY15 from 15.7% as on Q4FY14. It announced a dividend of ₹ 65/share, which was well received by investors. We believe, with the remaining cash of ~₹ 250-300 crore, the company will continue to reward investors ahead as its requirement for acquisitions (if any) is very low. Though valuations are at peak with P/E of 28x FY16E EPS, we believe due to niche business segment & its strong positioning, CARE can continue the uptrend from long term perspective.

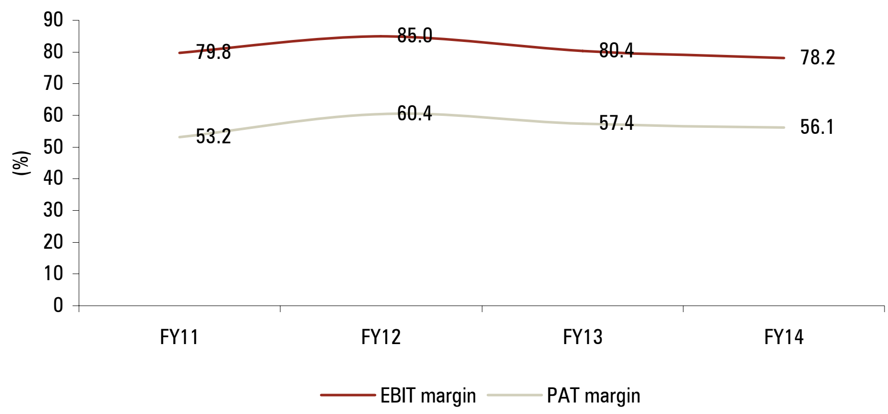
Exhibit 1: Financial Performance

(Year-end March)	FY11	FY12	FY13	FY14
Revenue	170.9	178.1	198.8	229.5
Expenses	40.4	54.9	67.5	85.7
EBIT	136.3	151.4	159.9	180.9
EBIT margin (%)	79.8	85.0	80.4	78.2
PAT	91.0	107.5	113.3	128.7
PAT margin (%)	53.2	60.4	57.0	56.1
EPS (₹)	30.5	36.1	39.7	44.5

Source: Company, ICICIdirect.com Research

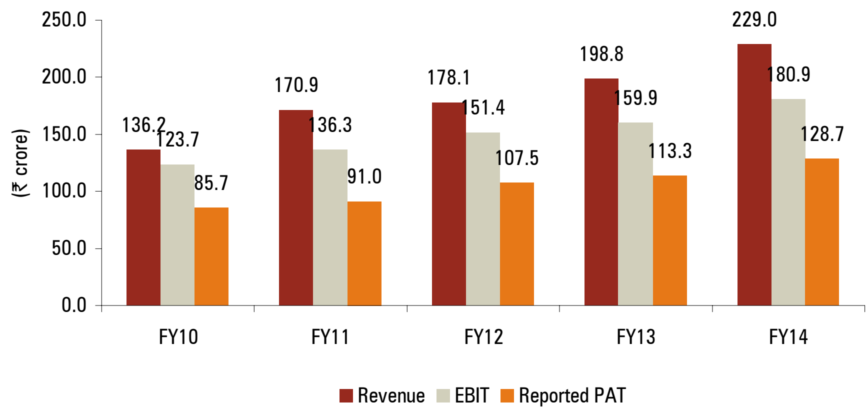
With the SME proportion (relatively low margin business) expected to go up and increasing competition, margins may decline slightly, going ahead, but are expected to still remain higher than peers

Exhibit 2: Stellar margins at both EBIT and PAT level



Source: Company, ICICIdirect.com Research

Exhibit 3: Financial performance trend in past five years



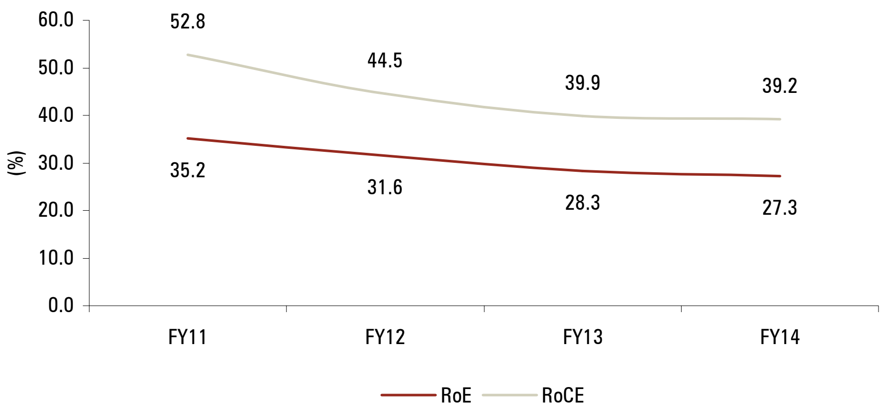
Source: Company, ICICIdirect.com Research

EBIT margin far superior than peers

A few parameters have played a key role for CARE to deliver superior margins. It has a higher focus on large and medium sized entities while Crisil and Icra have a relatively significant presence in the SME segment. The margins in the SME business are low, since the ticket size is small and higher manpower is required. The fees in the SME business range between ₹ 35000 and ₹ 45000. Besides, CARE has an internal centre in Ahmedabad wherein the data entry job is done by lower cost employees. It has a relatively lean management at the top and the pay scale is on the slightly lower side. Also, offices of CARE are mainly equity financed, which saves lease costs. Going ahead, with the SME business expected to pick up pace and higher competition, margins may decline slightly.

Relative to peers, a higher proportion (>95%) of its total revenue is generated from the rating business. The company earns far better EBIT margin (80%) in the rating business vs. ~45% for its peers.

Exhibit 4: Return ratios maintained at healthy levels consistently



Source: Company, ICICIdirect.com Research

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Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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